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By M. VAN SMITH*

Manipulation of commodity markets threatens the ability of persons in a society to barter for the necessities of life. For society to endure, therefore, the law must prevent manipulation.[1] A Roman official warned grain merchants who were witholding grain from a market:

> Apollonius to the grain merchants of Aspendus: the earth is the mother of us all, for she is just, but you in your injustice have acted as though she were your mother exclusively. If you do not stop, I will not let you exist upon her.[2]

To prevent powerful traders or speculators from manipulating commodity futures markets,[3] exchanges are regulated by the Com-

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* LL.B., University of Colorado, 1959.

1. *See generally* 2 R. POUND, JURISPRUDENCE 15, 312 (1959).
2. P. MACKENDRICK, THE ROMAN MIND AT WORK 105 (1958).
3. A commodity futures contract is a contract between a buyer and a seller in which the seller promises to deliver a particular commodity at an established future date. For a brief description of the process of commodity futures trading, see Smith, *Breaking the Chains that Bind: Arbitration Agreement Versus Forum Rights Under the Commodity Futures Trading Commission Act of 1974,* 16 SAN DIEGO L. REV. 749, 750 n.4 (1979). *See generally* S. ANGRIST, SENSIBLE SPECULATING IN COMMODITIES (1972); H. BAKKEN, FUTURES TRADING IN LIVESTOCK (1970); G. GOLD, MODERN COMMODITY FUTURES TRADING (1959); B. GOULD, DOW JONES-IRWIN GUIDE TO COMMODITIES TRADING (1973); T. HIERONYMUS, ECONOMICS OF FUTURES TRADING (1971); C. KELTNER, HOW TO MAKE MONEY IN COMMODITIES (1960); S. KROLL & I. SHISKO, THE COMMODITY FUTURES MARKET GUIDE (1973); R. TEWELES, C. HARLOW & H. STONE, THE COMMODITY FUTURES GAME (1974).

The interests in the contract are bought and sold on a commodity futures market, the "exchange," with standardized terms as to quality, quantity, and delivery specified by the exchange's rules and regulations. Standardization secures performance by making performance independent of the investor's finances. Because of standardization, commodity futures contracts are readily fungible. Jones & Cook, *The Commodity Futures Trading Commission Act of 1974,* 5 MEM. ST. U. L. REV. 457, 460 (1975). Price is the only negotiable term and must be negotiated by floor brokers who represent the trader on the floor of the exchange in an open bidding procedure. 7 U.S.C. § 6 (1976).

modity Futures Trading Commission (CFTC or Commission). Federal regulation of commodity futures exchanges began in 1922 with the Grain Futures Act,[4] which was amended in 1936 to increase the penalties and renamed the Commodity Exchange Act.[5] The Act remains the basis for government regulation of commodity futures markets today.[6]

The purpose of the Act is to prevent manipulation. Section 9(b) of the Act[7] makes it a felony "for any person to manipulate or attempt to manipulate," or to "corner or attempt to corner"[8] the price of any commodity for future delivery. Despite this express prohibition, manipulation remains a major problem.

The thesis of this Article is that government is incapable of preventing the manipulation of commodity futures markets because of the debilitating influence of law requiring that commodity futures contracts be performable by delivery. The Article first traces the historical development of the law requiring delivery. The Article then examines the flaws in the current market and the

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A trader who acquires an interest in buying a particular commodity is said to hold a "long" position; conversely, a seller is referred to as holding a "short" position. Traders in commodity futures do not buy the commodity per se; rather, they buy incorporeal contract rights or interests.

Because the futures contract is performed at a future date, it is possible for traders to intervene actively to change conditions, or merely to take advantage of natural changes in circumstances, between the date on which an interest is acquired and the delivery date. While it is from these fluctuations in conditions that a trader legitimately expects to make a profit, too aggressive a role in creating the changed circumstances creates an unfair advantage. This, very simply, is the problem of manipulation.

4. 42 Stat. 998 (1922) (current version at 7 U.S.C. §§ 1-22 (1976 & Supp. III 1979)).

5. 49 Stat. 1491 (1936) (current version at 7 U.S.C. §§ 1-22 (1976 & Supp. III 1979)).

6. *See* Commodity Exchange Act of 1922, § 3 (current version at 7 U.S.C. § 5 (1976)); H.R. REP. No. 421, 74th Cong., 1st Sess. 1-3 (1935); 80 CONG. REC. 6161, 6164 (1936) (remarks of Senator Pope); 62 CONG. REC. 9406, 9414 (1922).

7. Commodity Exchange Act of 1922, § 9(b), 7 U.S.C. § 13(b) (Supp. III 1979).

8. A "corner" generally refers to a situation in which the holder of a long position also has acquired a substantial portion of the deliverable commodity so as to obtain a dominant position in the cash market or spot market. *See* Comment, *The Delivery Requirement: An Illusory Bar to Regulation of Manipulation in Commodity Exchanges,* 73 YALE L.J. 171, 175 (1963) [hereinafter cited as *Delivery Requirement*]. *See also* Campbell, *Trading in Futures Under the Commodity Exchange Act,* 26 GEO. WASH. L. REV. 215, 237 n.41 (1958). A "squeeze" generally refers to the situation in which the trader has acquired a dominant position only in the futures market. A squeeze can result from a small corner or from a natural scarcity of a commodity. *See* J. BAER & O. SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 83 (1949) [hereinafter cited as COMMODITY EXCHANGES]. The effect of a corner or a squeeze is to give the trader substantial control over the price of the future as the delivery date approaches because the amount of deliverable commodity available is insufficient to fulfill the trader's futures contract.

regulatory framework, which make manipulation possible. Finally, the Article evaluates various proposals for alleviating the problem.

Development of the Delivery Requirement—The Competing Interests

The state's interest in preventing manipulation has provided an impetus for laws for as long as there have been commodity markets. In the fourth century B.C., Athens regulated its markets to ensure an adequate food supply.[9] In 483 A.D., Roman Emperor Zeno issued a decree to the Praetorian Prefect of Constantinople forbidding the manipulation of commodity markets.[10] The Muslim Code also forbade the buying of commodities intended for markets upon the roads outside of towns.[11] English laws against manipulation date from the 13th century.[12] In 1550, Parliament passed the statute of Edward VI, the principal statute against regrators, forestallers, and engrossers.[13] With the development of trade on the British Isles, however, the medieval statutory restrictions on free trade fell into disuse. Speaking of the statute of Edward VI, Adam Smith wrote in 1776:

> Our ancestors seem to have imagined that the people would buy their corn cheaper of the farmer than of the corn merchant,

9. J.M. Mehl, The Futures Markets, *Marketing*, 1954 Yearbook of Agriculture 324.

10. A. Eddy, The Law of Combinations 2 (1901). Romans suspected of cornering markets were stoned and their villas were burned. *See* P. MacKendrick, The Roman Mind at Work 21 (1958).

11. *See* W. Bewes, The Romance of the Law of Merchant 91 (1923).

12. *See* A Statute of the Pillory and Tumbirel, and of the Assize of Bread and Ale, 51 Hen.3, § 3 (1266). This statute fixed the prices of various commodities and directed local criminal courts to inquire into forestallers, defining them as persons "that buy anything afore the due . . . hour . . . or that pass out of the Town to meet such things as come to the Markets . . . to the intent they may sell the same in the Town more dear unto Regrators." *See also* Jones, *Historical Development of the Law of Business Competition*, 35 Yale L.J. 905, 907-908, 914 (1926).

13. An Act Against Regrators, Forestallers and Engrossers, 5 & 6 Edw.6, c.14, §§ 1-3 (1552). Engrossing was the practice of cornering supply by large purchases of a commodity. Forestalling consisted of intercepting suppliers on the way to a market and buying up commodities. Regrating was the creating of an artificial scarcity by buying up goods in the market and reselling them in or near the same market. *See also* 3 R. Anderson, Wharton's Criminal Law and Procedure § 1193 (1957); Mason, *Monopoly in Law and Economics*, 47 Yale L.J. 34, 38-39 (1937). The spirit of these ancient laws is embodied in provisions of the Commodity Exchange Act that authorize the government to prescribe limits on the number of commodity futures contracts that can be held for speculation. *See* Commodity Exchange Act of 1922, § 4a, 7 U.S.C. § 6(a) (1976).

> who, they were afraid, would require, over and above the price which he paid to the farmer, an exorbitant profit to himself. They endeavored, therefore, to annihilate his trade altogether. . . . The statute of Ed. VI, therefore, by prohibiting as much as possible any middle man from coming between the grower and the consumer, endeavored to annihilate a trade, of which the free exercise is not only the best palliative of the inconveniences of a dearth, but the best preventative of that calamity; after the trade of the farmer no trade contributing so much to the growing of the corn as that of the corn merchant.[14]

The repeal of the Act of Edward VI by the Act of George III[15] set the stage for a confrontation between the state's interest in preventing the manipulation of commodity markets and the merchants' interest in trading commodities as they pleased. In *Rex v. Rusby,*[16] the defendant was accused of the common law crime of regrating. The court found the defendant guilty, holding that regrating as a common law crime had not been repealed by the Act of George III. In his opinion, Lord Kenyon replied to Adam Smith's attack on the crime of regrating:

> I wish Dr. Adam Smith had lived to hear the evidence of today, and then he would have seen whether such an offense exists, and whether it is to be dreaded. If he had been told that cattle and corn were brought to market, and then bought by a man whose purse happened to be longer than his neighbor's, so that the poor man who walks the street and earns his daily bread by his daily labor could get none but through his hands, and at the price he chose to demand; that it had been raised 3d., 6d., 9d., 1s., 2s., and more a quarter on the same day,—would he have said there was no danger from such an offense?[17]

14. 2 A. SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, bk. IV, ch. IV (1776).

15. An Act for Repealing Several Laws, 12 Geo.3, c.71, § 1 (1772).

16. 170 Eng. Rep. 241 (1800).

17. *Id.* at 242. Lord Kenyon charged the jury: "This cause presents itself to [your] notice on behalf of all ranks, rich and poor, but more especially the latter . . . . The law has not been disputed; for though in evil hour all the statutes which had been existing above a century were at one blow repealed, yet, thank God, the provisions of the common law were not destroyed. The common law, though not to be found in the written records of the realm, has long been well known. It is contemporary with civilized society itself, and was formed from time to time by the wisdom of man . . . . Even amongst the laws of the Saxons are to be found many wise provisions against forestalling and offenses of this kind, and those laws laid the foundation of our common law. That it remains an offense, nobody has controverted . . . . It has been said that in one county, I will not name it, a rich man has placed his emissaries to buy all the butter coming to the market: if such a fact does exist, and the poor of that neighborhood cannot get the necessaries of life, the event of your verdict may be

Reacting to judicial decision holding that regrating, forestalling, and engrossing were common law crimes that had not been repealed by the Act of George III, Parliament abrogated those crimes by a general Act on July 4, 1844.[18] Parliament expressly provided, however, that the Act did not apply to the offenses of spreading false rumors to affect prices, or of preventing goods from being brought to market by force or threats.[19]

The Rule Against Wagers

Parliament's repeal of the common law crime of forestalling favored the merchants' interest in making profits. No longer illegal per se, manipulation was illegal only if accomplished through a conspiracy, by force, or by spreading false rumors.[20] This solution was, however, unsatisfactory. One person could legally manipulate a market so long as false rumors or force were not used. As a consequence, the law has been straining back towards Lord Kenyon's view that manipulation should be illegal per se.

The movement back towards Lord Kenyon's view came with alacrity as courts began to embrace the rule against wagers as a means of attacking the evil of manipulation. A wager is a bet or a contract by which two or more parties agree that a sum of money or other consideration shall be delivered to one of them on the occurrence or nonoccurrence of an uncertain event.[21] In the early common law, wagers were not void per se, but a particular wager was illegal if repugnant to morality or public policy.[22] In England, the Statute of Victoria in 1845 made all wagers nonenforceable.[23]

highly useful to the public." *Id.* at 242. *See also* King v. Wadington, 102 Eng. Rep. 56 (1800) (engrossing remained a common law crime even after the Act of George III).

18. An Act for Abolishing the Offences of Forestalling, Regrating, and Engrossing, 7 & 8 Vict., c.24 (1848). The Act nullified in whole or in part eighteen English statutes, ten Scottish statutes, and eight Irish statutes that restricted trade. Additionally, the Act's preamble made it clear that Parliament intended to overrule expressly those cases, such as *Rex v. Rusby*, that held that these common law crimes had been unaffected by the Act of George III.

19. *Id.* § 4.

20. *See* 1 A. EDDY, LAW OF COMBINATIONS 62 (1901); Mason, *Monopoly in Law and Economics*, 47 YALE L.J. 34, 38-39 (1937).

21. *See* BLACK'S LAW DICTIONARY 1416 (5th ed. 1979).

22. *See* J. DOS PASSOS, TREATISE ON THE LAW OF STOCKBROKERS & STOCK EXCHANGES 406-407 (1968).

23. An Act to Amend the Law Concerning Games and Wages, 8 & 9 Vict., c.109 (1845). Section 18 of the Act provided: "[A]ll Contracts or Agreements, whether by Parole or in

The first case decided under the Statute of Victoria, *Grizewood v. Blane*,[24] involved an agreement to sell to a stockbroker stock that the seller did not own at the time of contract, with the stock to be delivered at a future date. When the market price for the stock rose and the seller could not deliver at the price agreed upon, he promised to pay the difference between the sales price and the market price on the day set for delivery. The seller failed to perform his promise, and the broker brought an action for damages. As a defense, the seller pleaded that, under the Statute of Victoria, the contract was an illegal wager on the price of the shares. The case was submitted to a jury on the issue of whether the parties actually intended to sell the stock in question at the time the contract was made. The jury was instructed that, if the parties did not intend the actual delivery of the shares, the contract was a gambling transaction and therefore void. The jury found for the seller, and the verdict was sustained on appeal.[25]

Grizewood established the rule that the defense of an illegal wager raises a question of fact of whether the parties intended delivery. This rule was immediately accepted in the United States.[26] In *Weld v. Postal Telegraph-Cable Co.*,[27] the New York court stated:

> The generally accepted rule on this subject can be very simply stated. A man may lawfully sell goods or stock for future delivery, even though he has none in his possession, if he really intends and agrees to deliver them at the appointed time. Such a transaction constitutes a valid contract, which is enforceable in the courts. But a man may not, under the guise of such a contract, enter into a naked speculation upon the rise or fall of prices, in which there is to be no delivery of property, and no payment except such as may be necessary to provide for differences arising purely from market fluctuations. Such a transaction is a mere wager, which is condemned alike by statute and public

Writing, by way of gaming or wagering, shall be null and void; and that no Suit shall be brought or maintained in any Court of Law or Equity for recovering any Sum of Money or valuable Thing alleged to be won upon any Wager, or which shall have been deposited in the Hands of any Person to abide the event on which any Wager shall be made." *Id.* § 18.

24. 138 Eng. Rep. 578 (1852).

25. *Id.* at 583.

26. *See* Irwin v. Williar, 110 U.S. 499 (1884); Taylor, *Trading in Commodity Futures—A New Standard of Legality?*, 43 YALE L.J. 63, 67 (1933). *See also* J. DOS PASSOS, TREATISE ON THE LAW OF STOCKBROKERS & STOCK EXCHANGES 408 (1968).

27. 199 N.Y. 88, 92 N.E. 415 (1910).

policy.[28]

The courts embraced the intent-to-deliver rule as a means of attacking the evil of manipulation. This use of the intent-to-deliver rule conformed with the popular belief that gambling and manipulation were interrelated evils.[29] As one court stated, gambling caused

> [m]en of small means to enter into transactions far beyond their capital, which they do not intend to fulfill, and thus the apparent business in the particular trade is inflated and unreal, and like a bubble needs only to be pricked to disappear; often carrying down the bona fide dealer in its collapse. Worse even than this, it tempts men of large capital to make bargains of stupendous proportions, and then to manipulate the market to produce the desired price . . . .[30]

The rule requiring an intent to deliver introduced an element into the law of commodity futures trading that would later limit the courts' ability to clarify the law. Only a minuscule percentage of commodity futures contracts were performed by delivery.[31] To classify commodity futures contracts by the rule requiring an intent to deliver would be to classify commodity futures contracts as illegal gambling contracts. As a consequence, commodity futures contracts were widely condemned by statute and case law.[32]

The Grain Futures Act of 1922[33] logically should have preempted the state law that classified commodity futures contracts as illegal gambling transactions.[34] Despite the logic of preemption,

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28. *Id.* at 103, 92 N.E. at 420.

29. Typical of this belief was the statement of Senator Capper of Kansas in 1926 when he introduced a bill to ban shorting (selling) on commodity futures markets: "Inasmuch as selling, and nothing but selling, forces a decline, and inasmuch also as 90 percent of the selling is done by gamblers selling short to force a decline, it follows that speculative selling is the dominant factor in forcing a decline in the wheat market." COMMODITY EXCHANGES, *supra* note 8, at 79.

30. Kirkpatrick v. Bonsall, 72 Pa. 155, 158-59 (1872). *See also* Lyon & Co. v. Culbertson, Blair & Co., 83 Ill. 33, 39-40 (1876); Pickering v. Cease, 79 Ill. 328, 339 (1875); Lurie, *Commodities Exchanges As Self-Regulating Organizations in the Late 19th Century: Some Perimeters in the History of American Administrative Law,* 28 RUTGERS L. REV. 1107, 1130 (1975).

31. *See* REPORT OF THE GRAIN FUTURES ADMINISTRATION 46 (1924); Note, *Legislation Affecting Commodity and Stock Exchanges,* 45 HARV. L. REV. 912, 913-14 nn.8-9 (1932).

32. *Id.; see* Huff v. State, 164 Ark. 211, 261 S.W. 654 (1924); Baltimore Trust Co. v. Stanton, 144 S.C. 490, 142 S.E. 716 (1928); Palmer v. Love, 18 Tenn. App. 579, 80 S.W.2d 100 (1935).

33. 42 Stat. 998 (1922) (current version at 7 U.S.C. §§ 1-22 (1976 & Supp. III 1979)).

34. Taylor, *Trading in Commodity Futures—A New Standard of Legality?,* 43 YALE L.J. 63 (1933).

two cases decided by the United States Supreme Court prevented state law from being completely preempted.

The intent-to-deliver rule was first addressed by the United States Supreme Court in *Chicago Board of Trade v. Christie Grain & Stock Co.*,[35] in which the Chicago Board of Trade sought to enjoin the illegal use of its market quotations by a "bucket shop."[36] Instead of maintaining that it was not a bucket shop, the defendant accused the Chicago Board of Trade of being "the greatest of all bucket shops." To appreciate the ingenuity of this defense, it should be remembered that during the 1890's, several of the major bucket shops were larger and more affluent than the average New York Stock Exchange member firm.[37] Indeed, stock and commodity exchanges, no different in outward appearance from the legitimate exchanges, had been organized to facilitate the operation of bucket shops.[38] If the only difference between a wager and a legal transaction were whether the parties to the transaction intended delivery, there was nothing to distinguish the operation of any commodity futures exchange from the operation of a bucket shop or bucket shop exchange. It was inescapable that parties to commodity futures contracts generally intended to perform by settling on price differentials, or offsetting, just as did the bucket shops.

The Supreme Court thus faced an exquisite dilemma: if it decided that an intent to deliver was unnecessary, it would give a license to bucket shops; but if it decided that an intent to deliver was necessary, it would put legitimate commodity futures exchanges out of business. The Court neither gave a license to bucket shops nor put legitimate commodity futures exchanges out of business. It resorted to the legal fiction[39] that "a set-off is in legal effect

35. 198 U.S. 236 (1905).

36. A "bucket shop" was an establishment that gave the outward appearance of being a brokerage firm. Instead of actually executing a customer's order on an exchange, however, the order was "bucketed," being treated merely as a bet against the customer on the books of the bucket shop. Customers of bucket shops operated on margin, and the shops would "loan" them the balance owed on an order at an interest rate of up to twenty-five percent per annum. The bucket shop thus combined the business of bookmaker and loan shark on fictitious loans. R. SOBEL, THE CURBSTONE BROKERS 69 (1970). *See also* Smith, *The Commodity Futures Trading Commission and the Return of the Bucketeers: A Lesson in Regulatory Failure*, 57 N.D.L. REV. 7 (1981).

37. R. SOBEL, THE CURBSTONE BROKERS 71 (1970).

38. *Id.* at 63.

39. A legal fiction is a false statement made with a consciousness of its falsity. L. FULLER, LEGAL FICTIONS 9 (1967). One must assume that the Court never intended that offset and delivery literally be the same; rather, it decided to pretend that they were the

a delivery."[40]

By employing a legal fiction in *Christie*, the Supreme Court carved out a narrow exception for transactions executed on commodity futures exchanges from the rule requiring an intent to deliver. The Court adhered to the rule by limiting its decision to contracts executed on the floors of exchanges.[41] Thus, the Court preserved the intent to deliver rule for contracts not made on the floors of exchanges.

The campaign to put bucket shops out of business was too intense to accept such a facile distinction between the operation of bucket shops and the custom of offset. If an exception from the general rule had been made for all offsetting, no reason would have existed for not extending the same exception to any business of buying and selling stocks or commodities in which the parties sought to settle for price differentials rather than actual delivery. Thus, while it was obvious to the Court that a great financial institution such as the Chicago Board of Trade was not a bucket shop, the reason why it was not the "greatest of all bucket shops" did not seem obvious.

The second case in which the Court preserved the intent to deliver rule was *Dickson v. Uhlmann Grain Co.*[42] In *Dickson,* the United States District Court in Missouri had found in favor of customers challenging the validity of commodity futures contracts on the ground that the transactions violated the Missouri statute against gambling.[43] The Eighth Circuit reversed and the Supreme Court granted certiorari. In an opinion by Justice Brandeis, the

same. The decision thus was not simply an exercise in sophistry as one economist has accused it of being. *See* Working, *Economic Functions of Futures Markets,* in FUTURES TRADING IN LIVESTOCK 21 (H. Bakken ed. 1970) [hereinafter cited as Working] (misconstrues the effect of a legal fiction by stating that the Court found the required intent to deliver despite the parties' intentions to settle by offset). Nevertheless, the use of legal fiction as the basis for upholding the operation of worldwide commodity futures markets as a legitimate business is, in Professor Fuller's words, "infused with a certain puckishness." L. FULLER, LEGAL FICTIONS vii (1967).

40. 198 U.S. at 250.

41. *Id.* This exception was similar to one made in Harvey v. Merrill, 150 Mass. 1, 22 N.E. 49 (1889), in which the Supreme Judicial Court of Massachusetts held that contracts executed on a board of trade could be legal so long as the parties did not intend merely to settle on the differences in prices rather than to deliver.

42. 288 U.S. 188 (1933). *Dickson* is typical of the cases that hold fixtures trading to be illegal pursuant to the rule against wagers. In this case, contract invalidity was raised as a defense by customers who had suffered losses in the market. Taylor, *Trading in Commodity Futures—A New Standard of Legality?,* 43 YALE L.J. 63, 79 (1933).

43. 288 U.S. at 192.

Supreme Court reversed the court of appeals and held that the transactions were illegal under Missouri law.[44] On the question of preemption of Missouri law by federal law, the Supreme Court stated:

> The Grain Futures Act did not supersede any applicable provisions of the Missouri law making gambling in grain futures illegal . . . .
>
> The federal act declares that contracts for the future delivery of grain shall be unlawful unless the prescribed conditions are complied with . . . . Nor is there any basis for the contention that the Congress occupied the field in respect to contracts for futures delivery; and that necessarily all state legislation in any way dealing with that subject was superseded. The purpose of the Grain Futures Act was to control the evils of manipulation of prices in grain. Such manipulation, Congress found, was effected through dealings in grain futures.
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> Many persons had advocated, as a remedy, that all future[s] trading be abolished. Congress took a less extreme position. It set up a system of regulation and prohibited all future[s] trading which did not comply with the regulations prescribed. But it evinced no intention to authorize all future[s] trading if its regulations were complied with . . . . The Missouri law is in no way inconsistent with the provision of the federal act. It does not purport to legalize transactions which the federal law has made illegal. It does not prescribe regulations for exchanges. Obviously, manipulation of prices will not be made more difficult, because the state has declared that certain dealings in futures are illegal and has forbidden the maintenance within its borders of places where they are carried on.[45]

Under *Christie* and *Dickson,* the legality of commodity futures transactions between a customer and a brokerage firm were judged by a different standard than were transactions on an exchange between brokers. Owing to the fiction that offset was the same as delivery, the conflict between the custom of offset and the general rule against gambling transactions was never completely reconciled.[46] The rule requiring an intent to deliver cast a pall of illegality over commodity futures trading.[47] A disgruntled trader could

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44. *Id.* at 201.

45. *Id.* at 198-200 (citation omitted).

46. *See* Lurie, *Commodity Exchanges as Self-Regulating Organizations in the Late 19th Century: Some Perimeters in the History of American Administrative Law,* 28 RUTGERS L. REV. 1107, 1130 (1975).

47. *See* Irwin, *Legal Status of Trading in Futures,* 32 ILL. L. REV. 155, 169-70 (1937)

always cry foul and run to the courthouse for sanctuary.

To avoid the common law rule against wagers, commodity exchanges adopted rules requiring all contracts that were not offset to be performed by delivery.[48] It thus became generally accepted that, to avoid the taint of illegality, commodity futures contracts had to provide for delivery. This dogma became ingrained in federal law and was implicit in the Commodity Exchange Act's requirement that delivery be located either at terminal markets where there was an inspection service or at delivery points approved by the Secretary of Agriculture.[49] The delivery requirement was also implicit in the federal regulators' approval of commodity futures contracts that required delivery.

Determining Manipulation: The Lack of a Model

Although federal legislation prohibiting manipulation has existed since 1922,[50] manipulation has yet to be defined by statute or regulation.[51] Manipulation is commonly understood as causing others to buy for more or to sell for less than they otherwise would have. Cases and administrative proceedings have referred to manipulation as the intentional creation of distorted prices.[52] This

[hereinafter cited as *Legal Status*].

48. *See* Note, *Legislation Affecting Commodity and Stock Exchanges*, 45 HARV. L. REV. 912, 913-14 n.14 (1932).

49. 7 U.S.C. § 7 (1976). *See* Campbell, *Trading In Futures Under The Commodity Exchange Act*, 26 GEO. WASH. L. REV. 215, 229 (1958).

50. The Grain Futures Act was passed in 1922. 42 Stat. 998 (1922) (current version at 7 U.S.C. §§ 1-22 (1976 & Supp. III 1979)).

51. Despite the lack of definition, the Grain Futures Act has been held not to be unconstitutionally vague. *See* Bartlett Frazier Co. v. Hyde, 65 F.2d 350, 354 (7th Cir.), *cert. denied*, 290 U.S. 654 (1933).

52. Arthur R. Marsh, former president of the New York Cotton Exchange, defined manipulation as "any and every operation or transaction, [or] practice, the purpose of which is not primarily to facilitate the movement of the commodity at prices freely responsive to the forces of supply and demand; but, on the contrary, is calculated to produce a price distortion of any kind in any market either in itself or in its relation to other markets. If a firm is engaged in manipulation it will be found using devices by which the prices of contracts for some one month in some one market may be higher than they would be if only the forces of supply and demand were operative; or using devices by means of which the price or prices of some month or months in a given market may be made lower than they would be if they were freely responsive to the forces of supply and demand. Any and every operation, transaction, [or] device, employed to produce these abnormalities of price relationship in the futures markets, is manipulation." *Cotton Prices: Hearings Before A Subcomm. of the Senate Comm. on Agriculture and Forestry*, 70th Cong., 1st Sess. 201-03 (1928). *See also* Volkart Bros. v. Freeman, 311 F.2d 52, 58 (5th Cir. 1962).

definition is circular, however, for "distortion" is merely a synonym for "manipulation."[53]

As an economic problem, manipulation consists of more than causing a price change. Every trading decision affects the market. To the extent that any effect on a market causes others to react, all trading decisions involve some degree of manipulation. Manipulation, then, is not an absolute concept, but rather is the use of excessive influence. The problem has been to decide at what point lawful influence becomes unlawful manipulation.

There are two ways to distinguish lawful conduct from manipulation. One way is to let prices gauge when manipulation has occurred. Manipulation occurs when prices are distorted beyond normal supply and demand. Price distortion is the criterion favored by economists of Adam Smith's school of thought.[54] The economist sees manipulation as a maladjustment of the relationship between demand and supply. The other way to determine manipulation is to focus on intent. Conduct becomes manipulation when a person acts with the intent to manipulate. Intent is the criterion favored by Lord Kenyon's school of thought.[55] The lawyer sees manipulation as the outward manifestation of an evil intent. Price distortion is evidence of wrongful conduct rather than the wrongful conduct itself. By using intent to decide whether a trader has been guilty of manipulation, one need not show that a trader has caused a change in prices. Intent to use conduct to force others to act makes one guilty of manipulation regardless of whether the price is distorted.

These two ways of deciding whether manipulation has occurred are inconsistent. With price distortion as the test, even though a person acts with an intent to manipulate, a person is not guilty of manipulation unless the conduct has in fact distorted prices. With intent as the test, however, one can be guilty of manipulation without distorting prices.

Although price distortion and intent are inconsistent criteria, the government has typically attempted to use both in prosecuting manipulation cases.[56] Price distortion has been given the most attention, however, in large part because of the predominant role played by economists in the federal regulatory structure. The con-

53. *See* I. COPI, INTRODUCTION TO LOGIC 115 (1953).

54. See note 14 & accompanying text *supra.*

55. See note 17 & accompanying text *supra.*

56. *See, e.g., In re* Indiana Farm Bureau Coop., [1979] COMM. FUT. L. REP. (CCH) ¶ 20,964.

centration on price distortion was also a logical result of the rule that contracts had to be performable by delivery to avoid the taint of illegality. Inasmuch as the law required a trader to intend delivery, it is difficult to distinguish the intent to deliver from an illegal intent to manipulate when a trader insists on delivery.

As a consequence of the CFTC's emphasis on price distortion, manipulation has become difficult to prosecute. The variables affecting commodity futures prices can be overwhelmingly complex and are constantly changing.[57] Because of the complexity of factors affecting commodity futures prices, any charge that a trader's conduct caused a price distortion must be arbitrary to some degree.[58] In an extreme case of control over a market, there need be little supposition.[59] Generally, however, it is difficult to prove what effect control has on a market. It is always possible, consequently, for the defense to assert that a price change occurred because of factors other than an accused's conduct.

The Cargill Incident: The Difficulty in Proving Manipulation Through Price Distortion

The difficulty in proving manipulation through evidence of price distortion is well illustrated by the eight-year administrative proceeding that the United States Department of Agriculture initiated against Cargill, Incorporated in 1964.

Cargill, a large, privately-owned grain company and conglomerate,[60] was charged with manipulating the May, 1963 wheat futures market traded on the Chicago Board of Trade and the price of red winter crop wheat.[61] Early in 1963, Cargill believed that there would be ample supply of old crop soft red winter wheat at the end of the crop year in May, 1963,[62] so it hedged its inventory

57. *See* R. TEWELES, C. HARLOW & H. STONE, THE COMMODITY FUTURES GAME 147-49 (1974).

58. *See* Case Comment, *Commodities: Futures Control: Manipulation Under the Commodity Exchange Act*, 57 MINN. L. REV. 1243, 1251-52 (1973).

59. For example, in a case like Peto v. Howell, 101 F.2d 353 (7th Cir. 1938), in which the defendant owned 90% of deliverable supply in the United States and 97% of Chicago deliverable supply, the effect of the manipulator's conduct becomes certain.

60. *See generally* D. MORGAN, MERCHANTS OF GRAIN (1978).

61. *See In re* Cargill, Inc., 29 Agric. Dec. 880 (1970).

62. Soft red winter wheat is grown chiefly in Illinois, Indiana, and Ohio. In 1963 soft red winter wheat accounted for approximately fifteen percent of the total United States wheat crop. It is this wheat that is used by the mills in the Chicago area, with ten to sixteen million bushels usually accumulated and warehoused in Chicago for sale to the Illinois mills,

of soft red winter wheat by selling May, 1963 futures on the Chicago Board of Trade.[63] During February, Cargill sold substantial amounts of cash soft red winter wheat to mills in the southwestern United States;[64] this demand continued into March.[65] Cargill then changed its opinion of the supply-demand situation, concluded that old crop wheat would be scarce, and began to close out its short (sell) hedge of May 1963 futures.[66]

In March, the Spanish Government expressed interest in buying wheat from Cargill.[67] Cargill continued to close out its short May, 1963 hedge, and by April 11, 1963, had reduced its short position to 570,000 bushels.[68] On April 15, the next business day, Cargill bought 820,000 bushels of May 1963 futures, thereby closing out its short hedge and establishing a long (buy) position of 250,000 bushels.[69]

As of April 12, 1963, there was a total of 2,804,000 bushels of deliverable grade wheat stored in Chicago warehouses, of which 200,000 bushels were stored in warehouses that were not regular for delivery.[70] Of the total wheat warehoused in Chicago, Cargill owned 2,471,000 bushels, or about eighty-eight percent.[71] Cargill knew from weekly United States Department of Agriculture re-

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to other states, and abroad.

The crop year for wheat in the United States is from June 1 to May 31 of the following year. The delivery months for Chicago futures are July, September, December, March, and May. The May 1963 contract was, therefore, the last futures contract for the 1962-1963 crop (old crop); the July 1963 contract was the first contract for the 1963-1964 crop year. *Id.* at 888.

63. Hedging acts as a form of insurance for a party buying or selling a particular commodity. Thus, the buyer of a commodity that cannot be sold for a period of time can sell a corresponding amount of futures in that commodity at the same time the commodity is purchased. When the actual commodity is sold, a corresponding purchase of futures will be made to offset the original sale of futures. The effect is that any fluctuations in the price of the commodity will be approximately reflected in the futures. Thus, any losses, or gains, will be cancelled out, giving the person a measure of security in the market. *See Delivery Requirement, supra* note 8, at 172.

64. *In re* Cargill, Inc., 29 Agric. Dec. 880 (1970). The Chicago wheat futures contract is essentially a soft red winter wheat contract because No. 2 soft red winter wheat is the cheapest class and grade deliverable at par in satisfaction of the contract. Thus, wheat futures generally tend to reflect the value of No. 2 soft red winter wheat. *Id.*

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.* at 889.

69. *Id.*

70. *Id.*

71. *Id.*

ports that it owned most of the deliverable wheat in Chicago,[72] and it continued to add to its long position in May, 1963 futures.[73]

Early in May it became known that the Spanish Government would purchase large quantities of wheat, and, on May 11, it offered to buy 50,000 tons (2,000,000 bushels).[74] On May 18, the Spanish Government accepted Cargill's offers to sell 27,500 tons at prices profitable to Cargill,[75] and Cargill proceeded to load 770,000 bushels of wheat from its Chicago elevator to be shipped to Spain. This shipment and other commitments left Cargill with approximately 50,000 bushels of wheat warehoused in Chicago, which was all the Chicago wheat available for delivery on the May contract.[76]

The last day of trading of the May futures contract was May 21.[77] At the opening on May 20, Cargill had an open long position of 1,930,000 bushels.[78] May futures had closed the previous trading day at 2.03 ⅓ - 2.09 ½, and opened at 2.11 - 2.14.[79] At a meeting that day, Cargill officials decided to begin liquidation and gave an order to sell 100,000 bushels at 2.19, but Cargill's floor broker could sell only 40,000 bushels at that price.[80]

At the opening of trading on May 21, there was an open interest of 8,000,000 bushels, of which Cargill owned approximately twenty-four percent.[81] Trading opened at 2.22 and gradually declined to 2.15 ¼ by 11:02 a.m.; during this period Cargill purchased another 100,000 bushels, bringing its long position to 1,990,000 bushels. At 11:45, when the market was trading at 2.20, Cargill gave its broker price limit orders to sell on a scale up at prices from 2.27 to 2.28 ¼. The market did not reach the limits specified until 11:53. From this time until trading closed at around 12:00 p.m., Cargill's broker sold 1,625,000 bushels. Congestion was such that, at the close of trading, contracts for 420,000 bushels had

72. Cargill, Inc. v. Hardin, 452 F.2d 1154, 1159 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972).

73. *In re* Cargill, Inc., 29 Agric. Dec. 880, 889 (1970).

74. Cargill, Inc. v. Hardin, 452 F.2d 1154, 1159 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972).

75. *Id.*

76. *Id.*

77. *In re* Cargill, Inc., 29 Agric. Dec. 880, 893 (1970).

78. *Id.*

79. *Id.* Prices are quoted at dollars per bushel.

80. *Id.*

81. Cargill, Inc. v. Hardin, 452 F.2d 1154, 1160 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972).

not been closed out, of which Cargill had contracts for 365,000 bushels.[82]

After trading had closed on May 21, an official of the Chicago Board of Trade sought Cargill's cooperation in the orderly liquidation of the open contracts because of the scarcity of soft red wheat in the Chicago area and suggested that Cargill offer to sell warehouse receipts to the shorts in order to close out the open contracts.[83] Cargill replied that it only had around 35,000 bushels that were uncommitted, but that it would make substantially greater amounts of warehouse receipts available at 2.28 ¼ if it could be assured of receiving these receipts back in settlement of its long position, because the wheat was needed for delivery on prior commitments.[84] There were no other warehouse receipts available in Chicago for delivery against the May contract.[85] After the Board assured Cargill that it would get its receipts back, Cargill sold warehouse receipts for 2.28 ¼ per bushel, which it then recovered and sold to other persons holding short positions, who in turn used them to deliver on their short contracts.[86]

After all the open May contracts were settled, Cargill had 88,000 bushels of old crop wheat in its warehouse. Between June 4 and June 13, Cargill sold this wheat at prices ranging from 2.10 to 2.13 per bushel.[87]

The administrative proceeding against Cargill required thirty-two days and resulted in a 4,715 page record with oral testimony by some 50 witnesses and over 200 exhibits.[88] The hearing examiner wrote a 112-page decision, finding that Cargill had manipulated the market and recommending that Cargill be suspended as a futures commission merchant for ninety days.[89] Except for the penalty, which was suspended because of the protracted length of the proceeding, the recommended decision was accepted by a judicial officer in a thirty-five page opinion.[90] Cargill filed a petition in the court of appeals to set aside the finding that it and four of its

82. *Id.*
83. *Id.*
84. *Id.* at 1160-61.
85. *Id.* at 1161.
86. *Id.*
87. *Id.*
88. *In re* Cargill, Inc., 29 Agri. Dec. 880, 882 (1970).
89. *Id.* at 881-83.
90. *Id.* at 915.

officers had manipulated the May, 1963 wheat futures market.[91] In December, 1971, the court of appeals affirmed the order.[92]

The court of appeals divided the government's case into four elements: (1) Did Cargill hold a dominant long position in the future? (2) Was there an insufficient supply of wheat available from sources other than Cargill for delivery on the May futures? (3) Did Cargill exact an artificially high price in settlement of its long futures contracts? and (4) Was the squeeze intentionally caused by Cargill?[93] The first three elements were relevant to the question whether Cargill had caused the artificially high price but were immaterial to the question whether Cargill intended to manipulate. If an intent to manipulate was all that was necessary to make the conduct wrongful, the effect on the market would only have been evidence of the intent. The evidence on the question of price distortion would have been superfluous.[94]

One problem in establishing price distortion is the difficulty in comparing futures prices with cash prices. Because cash and futures prices should converge at the delivery date of a futures contract, a discrepancy between cash and futures prices at delivery date theoretically shows manipulation. This proof assumes that the cash market is a true criterion of price. The comparability of cash and futures prices, however, raises complicated collateral issues. The court of appeals in *Cargill* recognized this:

> The problem with matching theory to fact lies in the difficulty of determining the cash price of wheat, for actual cash trades on the Chicago spot market are relatively infrequent and the prices of individual transactions may vary greatly depending on the positions of the parties, the quantity involved, and the time of the transaction.[95]

The court observed in a footnote that there had been only one cash transaction from February 21 until the closing of May futures on May 21.[96] The government relied on cash prices of wheat

91. Cargill, Inc. v. Hardin, 452 F.2d 1154, 1156 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972).

92. *Id.*

93. *Id.* at 1164-70.

94. The Act was amended in 1936 to make intent to manipulate sufficient to violate the statute. 7 U.S.C. § 9 (1976). This was thought to correct the "manifest mistakes" revealed in Wallace v. Cutter, 298 U.S. 229, 237 (1936), that mere attempts to manipulate were not prohibited. *See* 80 CONG. REC. 1451 (1936).

95. 452 F.2d at 1168.

96. *Id.* at 1168 n.12.

quoted by the Grain Market News, a publication of the Department of Agriculture.[97] In its defense, Cargill relied on reports by Sosland Trade Publication, which it contended was the more reliable source.[98] The small number of cash transactions and the fact that there were some sales in the 2.27-2.28 range were insufficient evidence that the 2.27-2.28 price was caused by the alleged manipulation by Cargill. A number of Cargill's witnesses testified that the futures price was actually not out of line with cash prices and reflected basic factors of supply and demand.

Recognizing that the evidence as to the "proper" price was conflicting, the court noted the fact that on May 21, the futures market traded at 2.20, well below the 2.27-2.28 ¼ that Cargill had demanded during the final fifteen minutes of trading.[99] The court concluded, "[i]t seems clear that the only reason the price advanced so rapidly during the last few minutes of trading was . . . Cargill's dominance of the long interest and the high prices it set for liquidation."[100]

The court assumed that 2.28 was a manipulated price because the market had traded substantially lower earlier during the day. Given the volatility of commodity futures markets, however, a large price increase by itself does not establish manipulation. When there is a small number of market participants, which is usually the situation on the last few days of trading, prices can undergo substantial changes with little trading. This thinness of the market was just as likely the cause of the large price increase as was any manipulation by Cargill.[101]

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97. *Id.* at 1168. The cash prices quoted by USDA Grain News were as follows:

May 17	2.15 ½
May 20	2.18 ¾
May 21	2.28
May 22	2.15
May 23	2.11 ⅛
May 29	2.03 ⅜

Id. at 1168 n.13.

98. *Id.* at 1169. The Sosland card showed the cash prices on the relevant dates to be:

May 20	2.27 ½
May 21	2.40
May 22	2.09
May 24	2.11
May 31	2.03 ⅜ bid

Id. at 1168 n.13.

99. *Id.* at 1169-70.

100. *Id.* at 1170.

101. *See In re* Indiana Bureau Coop. Assn., Inc. [1979] COMM. FUT. L. REP. (CCH)

The conclusion that Cargill's holding out caused prices to increase was weakened by the lack of evidence on what the other traders had done and why they had done so. Market prices are as much the result of what buyers are willing to pay as what sellers are willing to accept. Because of the lack of evidence on the motivations of the other traders, the court had to assume that the persons holding short positions were forced to do the bidding of Cargill.[102] There was no evidence, however, that the persons holding short positions were unable to close out their futures contracts with other traders.[103] It is possible that the persons holding short positions waited until the final fifteen minutes of trading because they hoped the price would fall below 2.20. Although the court of appeals may have been correct in assuming that there were no other traders willing to sell during the final fifteen minutes of trading, this was only an assumption.

That the court assumed that the persons holding short positions were forced to pay 2.28 thus reveals that its decision was not really premised on proof of an artificial price increase. When all is said and done, the case came down to the fact that Cargill had held out for delivery when there was no reason to do so other than to force the persons holding short positions to pay its price.[104] The court found this fact to be so irresistible that it found Cargill caused a price distortion despite the lack of evidence of a causal relationship between Cargill's conduct and the activity of the persons holding short positions.

¶ 20,964, at 23,860 ("When a futures market takes toward expiration with declining open positions it necessarily becomes oligopolistic and oligopsonistic since the actions of any one participant affect price. The last contract bought and sold is 100 percent of the market.").

102. "The shorts as a practical matter had nowhere else to go except to Cargill and Cargill knew it." 452 F.2d at 1172.

103. A short position can be closed out (offset) by buying a long position. To be able to close out, a short has to negotiate a price with a party who is selling.

104. This is also demonstrated by the court's conclusion that Cargill had intentionally squeezed the market based on Cargill's having exploited its position while most of the other persons holding long positions did not. The court noted the manipulative nature of such conduct, stating: "While the obligation to make or take delivery is a bona fide feature of the futures contract, in reality the futures market is not an alternative spot market for the commodity itself, and indeed the functions performed by the futures market would probably be severely hampered if it were turned into an alternative spot market. Most parties who engage in futures transactions are in no position to either make or take delivery, and if they were required to always make preparations to fulfill their obligations to make or take delivery, the number of persons who could effectively participate in the futures market would be substantially restricted, thus reducing the liquidity and volume of that market." 452 F.2d at 1172-73.

If the court had decided the case merely on the basis that Cargill held out to force prices higher, the question of whether Cargill actually caused a price distortion was superfluous. Considering the difficulty of proving a causal relationship between conduct and price distortion, the government could have presented a much stronger case by concentrating on Cargill's intent to manipulate, rather than confusing its case by trying to show a price distortion.

Cargill's petition for certiorari was denied in 1972.[105] Thus, the legal proceedings did not finally end until eight years after Cargill had been charged. The length of this proceeding alone shows the futility of attempting to prove manipulation through price distortion.

The Intent-to-Deliver Rule and Natural Squeezes

An even greater weakness of the price distortion test is its inability to govern the situation in which manipulation has been accomplished without control of the deliverable supply. In cases in which a manipulator has not actively acquired control of the deliverable supply of a commodity, the rule requiring an intent to deliver has had an insidious effect.

Inasmuch as parties to commodity futures contracts could lawfully insist on performance by delivery, manipulation had to be based, at least ostensibly, on a manipulator's acquiring control over the cash market and using that control to force others to do the manipulator's bidding. Because there is nothing inherently unlawful in simultaneously having a large position in a cash market and a large position in its counterpart in the futures market, intent to manipulate had to be inferred from conduct of debatable legality. Hence, instead of being able to say that someone had manipulated a market simply by insisting on delivery—generally the only clear evidence of manipulation—a charge of manipulation required evidence of aggressive actions by a trader in an attempt to gain control of cash markets.

Unfortunately for those who would prove a manipulation, it is common for deliverable supply to be smaller than the amount demanded by futures contracts. Such a situation is referred to as a "natural squeeze."[106] In a natural squeeze market, all that a poten-

105. 406 U.S. 932 (1972).

106. *See* Cargill, Inc. v. Hardin, 452 F.2d 1154, 1161 (8th Cir. 1971), *cert. denied*, 406

tial manipulator must do to force the persons holding short positions to pay the demanded price is to insist on the lawful right to delivery. To demonstrate that a trader holding a substantial long position intended to manipulate the market by demanding delivery in the face of a natural squeeze, it became necessary to infer unlawful conduct from buying or selling "too much"—conduct that was, in the abstract, lawful.

If a line could be drawn between lawful conduct and manipulation, it would be a quillet. Because the determining factor is the degree to which prices can be shown to have caused distortion, manipulators could squeeze a market until government regulators ordered them to stop. Even if the manipulator refused to desist as ordered, prosecution could be so long and exhausting that government officials would be forced to tolerate all but the most blatant manipulation.

Volkart Brothers, Inc. v. Freeman

The incompatibility of the intent to deliver rule and the policy of preventing manipulation is exemplified by the case of *Volkart Brothers, Inc. v. Freeman.*[107] The Volkart Brothers firm was a wholesale dealer in cotton and a member of the New York and New Orleans Cotton Exchange.[108] In October 1955, Volkart held a substantial long (buy) position in the October cotton futures contracts traded on the New York Cotton Exchange. While other persons with similar positions were closing out their contracts, Volkart not only kept its position on the New York Cotton Exchange, it acquired more long cotton futures on the New Orleans Cotton Exchange. By October 11, Volkart knew that the supply of cotton deliverable against the long contracts it held was less than one-half the amount needed. Volkart kept its long position through October by offering to sell only at prices slightly above the market. On the last day of trading, Volkart raised the price at which it was willing to sell, forcing those who held short (sell) contracts to pay its price, which yielded a profit of over $20,000.[109]

Those parties injured by the manipulation initiated an administrative proceeding by the Department of Agriculture. The hear-

U.S. 932 (1972).

107. 311 F.2d 52 (5th Cir. 1962).

108. *Id.* at 53.

109. *Id.* at 58.

ing officer found Volkart guilty of manipulation and ordered its trading privileges suspended for fifteen days.[110] The Fifth Circuit reversed the administrative decision, holding that the weight of evidence did not support a finding of manipulation or attempted manipulation.[111] The court reasoned that Volkart had not manipulated the market because it had merely exploited a squeeze, rather than having caused it.[112] Faulting Volkart for merely insisting on delivery, in the view of the court of appeals, would have amounted to excusing the sellers from the performance of their contracts. Moreover, the court implied that if delivery could not be insisted upon, the cotton futures contracts would be illegal wagering contracts.[113]

Volkart exposes the incompatibility of requiring contracts to be performable by delivery and the policy of preventing manipulation. If manipulation is defined as forcing others to pay too much or to sell for too little, Volkart manipulated the cotton futures market because it had no reason for holding its contracts for delivery other than to force the persons holding short positions to pay its price. Yet, paradoxically, Volkart's holding for delivery could not have been a manipulation. Having done no more than take delivery, Volkart only did what it had a legal right to do. To have found Volkart guilty of manipulation would have resulted in the legal absurdity of finding that the exercise of a lawful right was unlawful.

The *Volkart* decision has been criticized as allowing manipulation by squeezes.[114] The decision, however, was the ineluctable consequence of the delivery requirement. What was wrong in *Volkart* was not the court's reasoning, but its failure to understand that, despite the formal terms of the contract, it was wrong for the cotton firm to have insisted on delivery. The dilemma epitomized by *Volkart* is the problem that continues to confound those who would prevent the manipulation of commodity futures markets.

110. *Id.* at 53.

111. *Id.* at 60. The decision has been criticized for not stating why the weight of evidence was insufficient. The court did specifically disagree with the judicial officer's decision that Volkart had been wrong in holding its contracts for delivery. *Id.*

112. 311 F.2d at 59.

113. *Id.* at 60.

114. *See* Cargill, Inc. v. Hardin, 542 F.2d 1154, 1173 (8th Cir. 1971), *cert. denied* 406 U.S. 932 (1972); *Delivery Requirement, supra* note 8, at 171.

Federal Regulation: A History of Failure

Conventional thinking holds that the key to preventing manipulation is to have delivery terms with enough grades and enough delivery points that deliverable supply cannot be controlled or exploited.[115] Such terms could have been implemented under the Commodity Exchange Act, which required contract markets (commodity exchanges) to provide for the prevention of manipulation as a condition of government approval and continued approval.[116] The approval power could have been used by federal officials to instigate delivery terms or exchange procedures that would allow contracts to be settled by payment in lieu of delivery under certain circumstances.

Government regulators were unwilling to use this power.[117] This left them nowhere to go but to a policy of expansion of delivery terms. Being subverted by the intent-to-deliver rule, government efforts to prevent manipulation were reduced to a futility. This is illustrated by the history of the government efforts to regulate the wheat futures contract traded on the Chicago Board of Trade.

The first administrative proceeding, involving the manipulation of May Chicago wheat in 1959 by two employees of E. F. Hutton, was "successful" only because the employees consented to an order that they had manipulated March and May wheat futures.[118] The consent decree resulted in an eight-month suspension of trading privileges.[119]

The next administrative proceeding came in 1964, the eight-year legal proceeding against Cargill, Incorporated. The lack of ef-

115. *See, e.g.*, Hieronymus, *Manipulation In Commodity Futures Trading: Toward a Definition*, 6 HOFSTRA L. REV. 41, 47-48 (1977). If the solution were as simple as the conventional wisdom supposes it to be, one would think that in the more than 50 years that commodity exchanges have been regulated under the Commodity Exchange Act, manipulation would have been eliminated. For a thorough discussion of the ineffectiveness of merely expanded delivery points and liberalized delivery terms as a means of preventing manipulation, see notes 127-147 & accompanying text *infra*.

116. 7 U.S.C. § 7(b) (1976).

117. *See Small Business Problems Involved in the Marketing of Grains and Other Commodities, Hearings Before the Subcomm. on Small Business Problems of the Permanent Select Comm. on Small Business*, 83d Cong., 1st Sess. 335 (1973) (statement of Alex C. Caldwell); Comment, *Federal Regulation of Commodity Futures Trading*, 60 YALE L.J. 822, 834 n.62 (1951).

118. Henry H. Cate, CEA Docket No. 90 (1959).

119. *Id.*

fectiveness of this legal proceeding is demonstrated by the fact that in 1970, during the pendency of the first proceeding, Cargill was involved in a squeeze of the May, 1970 wheat contract. While the 1970 squeeze was not publicly reported, it was discussed in an audit report of the Department of Agriculture.[120] The only difference between the two squeezes was that in 1970, Cargill decided to stop squeezing the persons holding short positions after being warned by the Commodity Exchange Authority.

In the next administrative proceeding, Edward Cox and George Frey, two floor brokers on the Chicago Board of Trade, were accused of having acted in concert to manipulate the May, 1971 wheat contracts.[121] As a result of taking delivery and stopping delivery notices from May 7 through May 18, the two brokers owned or controlled seventy-five percent of the 780,000 bushels of deliverable wheat available in Chicago. By May 19, the floor brokers held contracts calling for delivery of 2,200,000 bushels. The complaint against them alleged that from 11:31 a.m. on May 19 until 12:00 noon, when the contracts expired, Cox and Frey sold 2,020,000 bushels at $1.70 per bushel, ¾ of a cent below the limit allowed for trading.[122] Alex Caldwell, Administrator of the Commodity Exchange Act, commented on the complaint, observing that, although in the past Chicago had an abundant supply of deliverable wheat, the city "no longer is a market for cash wheat and it's fairly easy for manipulators to get control of the limited supply and use it for their own advantage."[123]

The foregoing survey of federal regulation of Chicago wheat futures markets over a twenty-year period demonstrates the futility of the government's efforts to prevent manipulation. As Chicago waned as a cash market, the futures market became increasingly vulnerable to manipulation. Despite the increasing vulnerability of the market to squeezes, however, government regula-

120. *See* Audit Report No. 6110-1-C, Office of Inspector General of the U.S. Dep't of Agriculture (Sept. 15, 1971). This report was made "for official use only, indefinite retention," but came to the attention of the public in April, 1973, when it was made available to the Agriculture Appropriations Subcommittee during congressional hearings that preceded the Commodity Futures Trading Commission Act of 1974. *See* Schorr, *Agriculture Department's CEA Audit Fuels Concern Over Adequacy of U.S. Regulation*, Wall St. J., Apr. 2, 1973, at 18, col. 2.

121. *See In re* Cox and Frey, CEA Docket No. 192 (1972).

122. *Id.*

123. *Farm Agency Charges Brokers Manipulated Wheat Futures, Seeks Revised Contracts*, Wall St. J., July 12, 1972, at 6, col. 2.

tors had no authority to prohibit persons from insisting on delivery. Consequently, traders could squeeze wheat futures with impunity. Rather than being able to take swift and decisive action against manipulators, government regulators were reduced merely to cajoling manipulators to cease squeezing.

Irresolution of the Delivery Problem: The Commodity Futures Trading Act of 1974 and Expanded Delivery Points

In 1974, Congress passed the Commodity Futures Trading Commission Act.[124] The Act was the congressional response to the public's widespread belief that the grain companies and exchanges had taken advantage of grain sales to Russia to manipulate the commodity futures markets.[125] Although it was never shown that the tremendous price increases in cash and futures markets were attributable to anything other than sudden and severe shortages, the congressional hearings on the proposed legislation revealed the commodity futures markets' vulnerability to manipulation. The belief that government regulators needed to be able to investigate an expansion of delivery points found expression in section 208 of the Act.[126]

Section 208 expressly requires each contract market to permit delivery on, and establish locational price differentials for, futures contracts traded on contract markets in such a manner "as will tend to prevent or diminish price manipulation, market congestion, or the abnormal movement of such commodity in interstate commerce."[127] If a contract market, however, fails to enact rules that

124. Pub. L. No. 93-463, 88 Stat. 1389 (codified in scattered sections of 5, 7 U.S.C.).

125. *See generally* J. Trager, Amber Waves of Grain (1973).

126. 7 U.S.C. § 7(a)(10) (1976).

127. Section 208, 7 U.S.C. § 7(a)(10) (1976), in pertinent part, provides that each contract market shall "permit the delivery of any commodity, on contracts of sale thereof for future delivery, of such grade or grades, at such point or points and at such quality and locational price differentials as will tend to prevent or diminish price manipulation, market congestion, or the abnormal movement of such commodity in interstate commerce. If the Commission after investigation finds that the rules and regulations adopted by a contract market permitting delivery of any commodity on contracts of sale thereof for future delivery, do not accomplish the objectives of this subsection, then the Commission shall notify the contract market of its finding and afford the contract market an opportunity to make appropriate changes in such rules and regulations. If the contract market within seventy-five days of such notification fails to make the changes which in the opinion of the Commission are necessary to accomplish the objectives of this subsection, then the Commission after

"accomplish the objectives" of section 208, the Commission, after notice and opportunity for a hearing, may on its own initiative require the market to enact such rules as the Commission deems necessary.[128] Section 208 thus gives the CFTC authority over the designation of delivery points and locational price differentials on commodity futures contracts.

On January 16, 1976, the CFTC published a notice seeking comment on its attempt to formulate a policy for evaluating contract market delivery points and locational price differentials to determine compliance with the terms of section 208 and other relevant sections of the Act.[129] The Commission also sought comment on what policy, if any, should be developed for prescribing additional delivery points or locational price differentials under section 208. As the delivery point issue is more significant in commodities with higher relative costs of transportation and in those with distinct geographic markets, the CFTC was particularly interested in comments respecting the food and timber commodities.[130]

Under the impetus of section 208, Toledo, Ohio and St. Louis, Missouri were added as delivery points for corn futures.[131] Toledo,

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granting the contract market an opportunity to be heard, may change or supplement such rules and regulations of the contract market to achieve the above objectives: *Provided,* That any order issued under this [subsection] shall not apply to contracts of sale for future delivery in any months in which contracts are currently outstanding and open: *And provided further,* That no requirement for an additional delivery point or points shall be promulgated following hearings until the contract market affected has had notice and opportunity to file exceptions to the proposed order determining the location and number of such delivery point or points."

128. *Id.*

129. The notice sought comment regarding:
"1. The criteria which should be used to evaluate the desirability of a particular delivery point or set of delivery points for the purposes of reducing potential market congestion, manipulation, and abnormal movements of commodities in interstate commerce.
"2. The manner in which the locational price differentials between multiple delivery points should be established to prevent market congestion, manipulation and abnormal movements of commodities in interstate commerce.
"3. The use of multiple delivery points to circumvent the market congestion and manipulation which may occur when a terminal market of declining commercial importance is employed as the sole delivery location on a contract market, and the criteria for choosing additional or alternative delivery locations.
"4. Whether an increase in the number of delivery points for a contract, for the purposes of reducing the potential for manipulation and congestion, will in some other manner reduce the utility of the contract for price basing or hedging." *See* Commodity Futures Trading Commission, *Delivery on Commodity Futures Contracts, Notice of Public Hearing,* 41 Fed. Reg. 3336, 3337 (1976).

130. *Id.*

131. *See* CFTC Release No. 470-79 (Mar. 5, 1979).

which had been added as a delivery point for wheat futures in 1972 at the insistence of the CEA,[132] was also made a soybean delivery point.[133]

In a speech on March 5, 1979 to members of the National Grain and Feed Association, acting CFTC Chairman Seevers listed the addition of delivery points as one of the major steps taken to regulate commodity futures markets.[134] Within a few days of Seevers's speech, however, on March 15th, the CFTC was forced to order suspension of trading of the March wheat futures contract because manipulators were taking advantage of a natural squeeze.[135]

A particularly tight supply of soft wheat on the cash market, entirely owing to natural causes, caused the CFTC to become alarmed when a few speculators obtained over seventy-five percent of the long side of the market. After the premium between December, 1979 and March, 1979 futures widened from eight to thirty cents in less than a month, the CFTC warned the two traders holding the largest long positions. Ultimately, the December future liquidated at an unusually high price relative to the cash price and to other commodity futures.[136]

By March 1, the beginning of the delivery period of the March futures, half a dozen floor traders held approximately fifteen percent of the Chicago long contracts. The quantity of wheat necessary to fulfill these contracts was almost six times greater than the deliverable supply of wheat on hand in Chicago and Toledo. By the middle of the month, four speculators had increased their interest in the long position to more than ninety percent of the open interest. At the same time, one of the largest speculators—also a floor trader—had acquired almost one-half of the deliverable supply in Chicago and Toledo. The combination resulted in the largest delivery month March-May premium in five years.[137]

While these factors were combining to inflate Chicago futures

132. *See Small Business Problems Involved in the Marketing of Grains and Other Commodities, Hearings Before the Subcomm. on Small Business Problems of the Permanent Select Comm. on Small Business*, 83d Cong., 1st Sess. 325 (1973) (statement of Alex C. Caldwell).

133. *Id.*

134. *See* CFTC Release No. 470-79 (Mar. 5, 1979).

135. Unnumbered CFTC Release (March 20, 1979) (Statement of Commissioner Read P. Dunn, Jr.).

136. *Id.* at 1.

137. *Id.* at 2.

prices, wheat prices on the Kansas City and Minneapolis futures markets remained stable.[138] Normally, the resulting large price differentials would have caused wheat to move from these two markets to Chicago. However, the combination of a harsh winter, making delivery by any means extremely difficult, and a shortage of elevator capacity in Chicago and Toledo (because the elevators were filled with soybeans and corn waiting to be moved out), prevented the natural forces of supply and demand from operating.

With no indication that the speculators intended to reduce their long positions, the CFTC directed the Chicago Board of Trade to suspend trading of its March futures contracts as of March 15.[139] Although the order was premised on a finding that an emergency situation existed, the order did not require any reduction in the positions held by the large speculators. Rather, the emergency order only had the effect of closing the market to new traders. Nonetheless, on Sunday, March 18, the United States District Court in the Northern District of Illinois specifically found that no emergency existed and entered a preliminary injunction to enjoin enforcement of the CFTC order.[140] The Seventh Circuit denied a request to stay the lower court's injunction, so trading resumed unabated.[141] The Commission's emergency action did, however, appear to have a sobering effect. After coming close to having their speculation halted, the manipulators apparently believed it was a good time to take their profits and began liquidating their positions.

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138. "As a result of these rather flat prices, the Chicago future increased appreciably over both Kansas City and Minneapolis. Whereas on February 20, the Chicago March price was about 48 cents over Minneapolis, the premium widened to over 70 cents by March 2. In the same period, the Chicago future increased from 33 to 57 cents over the Kansas City future." *Id.* at 2.

139. Under § 8a(9) of the Commodity Exchange Act, if the Commission has reason to believe that an "emergency" exists with respect to the trading of a commodity futures contract, the Commission may direct the appropriate exchange to take whatever action is necessary, in the Commission's view, to maintain or restore order. 7 U.S.C. § 8a(9) (1976).

140. *See* Board of Trade of the City of Chicago v. CFTC, [1979] COMM. FUT. L. REP. (CCH) ¶ 20,780 (N.D. Ill. 1979). The remarks of Judge Grady are revealing: "So I am not of the view that I should be unduly deferential to the administrative determination here. I'm not called upon to judge some arcane question of commodity trading. I am frank to say that that would be beyond me. . . .

"Is there a crisis over there across the street?

"I don't think I need any extraordinary expertise to be able to come to some reasonable conclusion as to whether or not there is evidence from which the existence of such crises could be concluded." *Id.* at 23, 185-86.

141. Board of Trade of the City of Chicago v. CFTC, 605 F.2d 1016 (7th Cir. 1979).

The policy of the 1974 Act is to prevent manipulation by expanding the number of delivery points.[142] The experience of the 1979 squeeze, however, suggests that this policy cannot effectively deal with the *Volkart* dilemma. A multiplicity of deliverable grades and points may make commodity futures contracts somewhat less vulnerable to manipulation; nonetheless, markets with a multiplicity of deliverable grades and delivery points remain vulnerable. Even after Toledo was added as a delivery point, the Chicago Board of Trade wheat contract continued to be manipulated. Its continuing vulnerability was owing to the normal expectations of the traders in commodity futures contracts not to have to make or take delivery. Although commodity futures contracts retain the form of contracts for sale of commodities with terms calling for future delivery, in substance they are contracts for the purchase and sale of rights.[143]

Most traders do not have the capacity or experience to make or take delivery of a commodity. The only traders financially able to do so are the large processors, who are also the most likely to manipulate.[144] For most traders, it is cheaper to pay whatever is necessary to avoid delivery rather than to make or take delivery. The argument that all parties to commodity futures contracts should be prepared for delivery ignores the very purpose of a commodity futures market. The essence of commodity futures contracts is the ability to take a position in a market without the burden of ownership.[145] Delivery defeats this purpose. If parties must be prepared to make or take delivery, they are dealing not with a futures contract—a contract for legal rights in commodities—but with the commodities themselves. For this reason, an unusually high percentage of deliveries illustrates a distorted system of commodity futures trading,[146] the normal percentage of deliveries being less than one percent.[147] Because delivery is against the normal

142. This always has been the Department of Agriculture's main policy for preventing manipulation. *See* U.S. DEP'T OF AGRICULTURE, NEED FOR MULTIPLE DELIVERY POINTS IN GRAIN FUTURES 10 (1947).

143. *See* Bakken, *Adoption of Futures Trading To Live Cattle*, in FUTURES TRADING IN LIVESTOCK 57 (1970).

144. *See* Note, *Abuses in the Commodity Markets: The Need for Change in the Regulatory Structure*, 63 GEO. L.J. 751, 757-60 (1975).

145. *See Legal Status*, *supra* note 47, at 156; Working, *supra* note 39, at 6, 28; *Delivery Requirement*, *supra* note 8, at 183 n.74.

146. *See Legal Status*, *supra* note 47 at 161 n.20.

147. *See* COMMODITY EXCHANGES, *supra* note 8, at 210; *Delivery Requirement*, *supra*

expectation of parties to commodity futures contracts, so long as delivery is required, futures markets will be vulnerable to manipulation regardless of how many delivery points there are for a particular contract.

Suggested Alternatives

The Cash Market Distortion Test

There have been various proposals for dealing with the *Volkart* dilemma. One proposal, advocated by Thomas Hieronymus, is to tolerate any conduct as long as it does not distort cash prices.[148] Professor Hieronymus argues that "[m]arket regulation by government and by exchanges is an administrative limitation on market power. It limits the conflict that inheres in competitive price formation."[149] Recognizing the need for power to meet countervailing power, one must ask what "is the degree of conflict which should be tolerated."[150] The test formulated by Professor Hieronymus of the allowable degree is simply: "[N]o cash price and movement distortion, no punishable distortion."[151] Under this test, persons could insist on delivery as long as it did not cause a distortion in cash price or a flow of a commodity to or from a delivery point.

Although Professor Hieronymus uses different nomenclature, his approach is roughly the same as the Fifth Circuit's position in *Volkart.* Whereas Professor Hieronymus would require traders to contend with delivery as being necessary to the "integrity"[152] of a market, the *Volkart* court spoke of the "illegality"[153] of commodity futures contracts if parties were not able to insist on making or taking delivery. Both terms express the basic idea that traders ought to be prepared to perform their contracts by delivery and that to encourage them to do otherwise is wrong.

The view represented by *Volkart* and Professor Hieronymus—that persons who trade commodity futures contracts must

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note 8, at 183 n.73.

148. *See* Hieronymus, *Manipulation In Commodity Futures Trading: Toward A Definition,* 6 HOFSTRA L. REV. 41, 53 (1977).

149. *Id.* at 52.

150. *Id.* at 53.

151. *Id.*

152. *Id.*

153. *Id.* at n.107

be prepared for delivery or suffer the consequences—is too conclusory. Implicit in this view is that a commodity futures contract should be treated as a merchandising contract, which it is not and cannot be.

The approach advocated by Professor Hieronymus would merely make commodity futures contracts even more vulnerable to manipulation than they are now; a person would be free to manipulate as long as he or she did not distort cash prices. Professor Hieronymus does not explain how one decides when there has been a distortion in cash prices. Rather, he assumes that conduct that distorts futures prices will at some point distort cash prices. However, in a market like the cash wheat market described in *Cargill*—a market in which the cash transactions are so few as to be nominal—one cannot suppose that what happens to a futures market will have any effect on cash prices. One of the primary difficulties in proving manipulation of futures prices has always been the lack of relationship between futures prices and cash prices. If a relationship between cash and futures markets is lacking, which is often the case, Professor Hieronymus's test amounts to no more than greater freedom to manipulate futures markets.

The Good Faith Test

Another proposal for dealing with the *Volkart* dilemma is to require that traders act in good faith in insisting on delivery.[154] To rebut the inference of manipulation, a trader would have to prove that he or she acted in good faith in insisting on delivery. Good faith would be determined by comparing the trader's conduct to normal market conduct.[155]

The good faith rationale suffers from the same defect as does the *Volkart* view: both viewpoints concede too much to performance by delivery of commodity futures contracts. The good faith test would allow traders to insist on delivery if they act in good faith according to commercial practices. It is unclear, however, when it is not sound commercial practice to make a quick profit, as Cargill did in the 1964 squeeze. If good faith is to be determined by common commercial practice, a motive to make a profit would excuse manipulation. This argument was implicit in Cargill's

154. *See Delivery Requirement, supra* note 8, at 184.
155. *Id.* at 185.

defense.

The good faith rationale is unsound, although less so than the *Volkart* view, because it substitutes one fiction for another. The substance of commodity futures contracts is not delivery but offset. Delivery was a legal fiction adopted to preserve the form of legality against the threat posed by the general rule prohibiting wagers. If delivery is a legal fiction, the good faith of a person in insisting on delivery is also a fiction.

As with any fiction, the justification for the requirement of delivery must be to preserve the form of the law while the substance of the law undergoes a change. Whether the fiction of delivery was ever really necessary to preserve the form of legality of commodity futures contracts is debatable inasmuch as commodity futures trading originated in commercial practices and has always served a legitimate business purpose.

Delivery would probably have ceased to be significant long ago if there had been no need to believe in it. Delivery was, however, necessary in part to justify commodity futures trading—to make it something the general public could easily understand and accept. The attacks periodically made against commodity futures trading sustained the fiction of delivery. Against these attacks, commodity futures trading could be demonstrated not to be gambling by requiring that contracts be performed by delivery unless previously offset. Offset was perceived as a refinement of merchandising contracts and as merely a substitute for delivery rather than the purpose of commodity futures contracts. If offset were a substitute for delivery, delivery could not be eliminated.

The defense of commodity futures trading was as irrational as were the attacks on it. Instead of simply recognizing that commodity futures contracts should be treated as an exception to the intent to deliver rule, the apologists for commodity futures trading defended it on the ground that it involved real commodities that had to be delivered. In trying to pass commodity futures trading off as something it was not, however, the apologists aroused the very suspicions that they intended to allay. The insignificant percentage of commodity futures contracts that were performed by delivery merely confirmed popular suspicions about commodity futures trading. As a legal fiction, delivery failed to preserve the form of legality. More importantly, it gave rise to all of the mischief resulting from the rule that commodity futures contracts must be performable by delivery.

The Hindrance Test

A recent article by Edward McDermott sets forth a solution similar to the good faith approach.[156] Mr. McDermott begins his argument by observing that the conventional approach fails to consider all the variables that can affect the price of a commodity futures contract.[157] He then notes that the deficiencies of the conventional approach can be overcome by realizing that in the typical squeeze the manipulator

> threatens to demand delivery on what it has already bought or owns. The purchase or threat to take delivery after ownership has been secured serves no purpose except, of course, to hinder or prevent performance and inflate prices to the benefit of the longer trader on its resale. As such, it is not a bona fide transaction.[158]

Manipulation, therefore, can be attacked under the common law prohibition of "prevention" or "hindrance," which provided that a trader would be guilty of manipulation by acquiring enough deliverable supply to prevent the performance of contracts requiring delivery.[159] Hindrance could also be proved by other acts, such as monopolizing means of delivery or spreading false rumors, which hindered or prevented delivery.

Mr. McDermott develops the hindrance rationale to avoid the problem created by *Volkart.* Hindrance, as he has characterized it, would be nothing more than the common law crime of forestalling, that is, of preventing goods from reaching the market.[160] This definition is evident from his reference to hindrance by spreading false

156. *See* McDermott, *Defining Manipulation In Commodity Futures Trading: The Futures "Squeeze,"* 74 Nw. U.L. Rev. 202 (1979).

157. With regard to the leading manipulation cases, Mr. McDermott notes: "The analysis was indifferent to other market factors such as the composition or liquidity of the futures market at the relevant times, the number of orders placed and yet not filled, the trading pattern, and the nature and positions on the short side of the futures market." *Id.* at 209.

158. *Id.* at 214.

159. McDermott, *Defining Manipulation in Commodity Futures Trading: The Futures "Squeeze,"* 74 Nw. U.L. Rev. 202, 220 n.89 (1979).

160. *See* Jones, *Historical Development of the Law of Business Competition,* 35 Yale L.J. 905, 907 (1926). "The owners of the market or fairs usually exacted tolls on sales and a charge known as stallage for space for stalls in which to display goods. If they had a monopoly in specified territory their charges were often excessive. The obstruction of those coming to market so as to deprive the market owner of his stallage and the people of an unrestricted market in which to buy, was called forestalling and was unlawful, both at common law and under the statutes. At first the term seems to have been applied merely to physical obstructions to the movement of goods to the market, but the term quickly acquired a much larger significance." *Id.*

rumors, which was, at common law, merely a means of forestalling. It is difficult, however, to see how an understanding of the law of manipulation is advanced by labeling a trader's conduct "hindrance" rather than "forestalling," or even "manipulation." Mr. McDermott's hindrance test is tautological. Furthermore, the analogy between manipulation and hindrance breaks down in the situation in which a trader merely insists on delivery without having a position in the cash market. In this situation, Mr. McDermott must say that merely taking delivery is a hindrance. This goes beyond common law hindrance, which involved only actively buying up commodities that were to be delivered on a contract.[161] Although Mr. McDermott's criticism of the price distortion approach is well founded, the hindrance rationale fails to deal with the question of whether a trader can be guilty of manipulation by doing no more than taking delivery.

Eliminating Delivery

Various commentators have suggested that delivery probably could be eliminated from futures trading once the use of a market for hedging has become established.[162] Professor Bakken has gone a step further in describing the requirement of delivery as "a vestigial concept of an age-old custom that may be relegated to oblivion . . . ."[163]

It is possible that delivery could be effectively eliminated by procedures allowing for cash settlement in its stead.[164] On the Liverpool wheat futures market, for example, there is no rule or law requiring that a contract be performed by delivery rather than by a cash settlement. Procedures provide for an impartial determination of settlement price and any penalties to be paid in the case of default.[165] As a result of these procedures, no manipulation of the Liverpool wheat market has ever been detected, even though it appears particularly susceptible to manipulation because of the lim-

161. *See, e.g.*, Patterson v. Meyerhofer, 204 N.Y. 96, 97 N.E. 472 (1912); RESTATEMENT OF CONTRACTS § 295 (1932).

162. *See, e.g.*, Working, *supra* note 39, at 21.

163. Bakken, *Adoption of Futures Trading to Live Cattle*, in FUTURES TRADING IN LIVESTOCK 57, 66 (1970).

164. *See* COMMODITY EXCHANGES, *supra* note 8, at 84; H. IRWIN, EVOLUTION OF FUTURES TRADING 49 (1954).

165. *See* H. IRWIN, EVOLUTION OF FUTURES TRADING 50 (1954).

ited storage facilities available.[166]

The conventional argument against dispensing with delivery terms was that delivery is an essential connection between the "real" world of cash commodities and the world of commodity futures.[167] This connection was deemed necessary because the price of commodity futures contracts and the cash price of a commodity should and normally do converge at the time of delivery. Delivery is assumed to be the cause of this convergence. If the price of futures is too high, traders will sell futures and buy cash commodities, thus bringing futures and cash prices together. If the cash price is too high, traders will sell cash commodities and buy futures, thus bringing the cash price and the futures price together.

The fallacy in this argument is the underlying assumption that the physical act of delivery is the reason for the convergence of the prices. The minute percentage of contracts performed by delivery demonstrates this fallacy. The convergence of cash and futures must be a result of what people believe rather than what they do. The two prices converge because of what parties to commodity futures contracts must believe—that the value of intangible contract rights of a commodity futures contract is to be measured by the commodity's cash price. Parties to commodity futures contracts must believe this as there is no other rational standard by which to measure the value of the intangible contract rights.[168] That traders decide on trading strategies by making such a comparison before actual delivery proves that physical delivery is unnecessary.

Presuming Manipulation

If the only reason for delivery terms in commodity futures contracts were the conventional argument that it provides a nexus between the cash price of a commodity and the price of a commodity future, one could easily suggest that delivery be eliminated altogether. What has perpetuated the belief that commodity futures contracts must be performed by delivery, however, is far more

166. *See* Working, *supra* note 39, at 22.

167. *See* Futrell, *Do Live Futures Differ from Other Existing Futures Contracts?*, in FUTURES TRADING IN LIVESTOCK 72 (H. Bakken ed. 1970); Comment, *Manipulation of Commodity Futures Prices—The Great Western Case*, 21 U. CHI. L. REV. 94, 95 (1953).

168. Professor Commons classifies commodity futures contracts, along with other documents of intangible and incorporeal property, as "commodity tickets," which change in value with the value of the thing to which the ticket lays claim. *See* J. COMMONS, LEGAL FOUNDATIONS OF CAPITALISM 257 (1957).

compelling than the conventional argument for it. An instinct to protect business, coupled with a degree of self-interest, has perpetuated the belief in delivery. The first commodity futures markets developed spontaneously out of cash markets. Little thought was given to why commodity futures markets worked; it was enough to know that they did. Without knowing what effect eliminating delivery terms would have, the conservative view has always been to oppose any change. Delivery terms also contain an element of provincialism: Chicago wheat is Chicago wheat, not Toledo wheat. A contract that for decades had called for Chicago delivery may have delivery outside of Chicago. Some of the most influential patrons of commodity futures markets, the large hedgers and warehouses of Chicago wheat, were located in Chicago and were understandably interested in having delivery where it could be the most advantageous to them. They were far more influential than the farmers, who were not members of the exchanges.

Probably the most important reason for commodity futures contracts being performable by delivery has been the interest of the exchanges in maintaining a large volume of trading. To sustain volume, commodity futures markets must have a certain instability. If instability is eliminated so that the price in the future becomes certain, or relatively certain, the reason for commodity futures markets ceases. The *raison d'être* of commodity markets is uncertainty about the future.

Uncertainty is caused by variability in supply and demand, a variability that is augmented by delivery terms. Commodity futures contracts with narrowly specified deliverable grades or few delivery points are unstable because local conditions can readily affect deliverable supply. For the same reason, unfortunately, it is easier to control or exploit a market in which there is not a broad diversity of deliverable supply. The preeminent interest of commodity exchange members in sustaining a large volume of trading minimizes their interest in making commodity futures invulnerable to manipulation at the expense of that volume. This self-interest probably explains why exchanges have generally resisted proposals to prevent manipulation.[169] During the late 1800's and early 1900's,

169. *See* T. HIERONYMUS, ECONOMICS OF FUTURES TRADING 82-87 (1971); *Legal Status, supra* note 47, at 162 n.21; Lurie, *Commodity Exchanges As Self-Regulating Organizations In The Late 19th Century: Some Perimeters In The History of American Administrative Law*, 28 RUTGERS L. REV. 1107, 1132 (1975).

for example, the membership in the Chicago Board of Trade periodically defeated attempts to liberalize delivery terms.[170]

The belief that delivery is necessary to sustain a volume of trading sufficient to keep commodity futures markets operating successfully also explains government regulators' unwillingness to use their power to create a multiplicity of delivery points and grades. Government regulators sympathized with the interest of exchanges in attracting the volume adequate to sustain trading.

The interest of exchange members in having sufficient volume to sustain commodity futures markets is a legitimate interest. Trading volume is essential to liquidity. Vulnerability to manipulation can be seen as the *quid pro quo* for trading volume. Price *movement* is the cynosure that attracts trading.

The interest in trading volume and its relation to delivery terms would have been more widely understood if it had been debated openly. It would have been tantamount to heresy, however, for those who extol the use of commodity futures as a way of ensuring against risk to advocate instability at the same time. Therefore, the exchanges' interest in somewhat unstable markets has been promoted by other arguments, such as the rule against wagers or that delivery is necessary to connect cash and futures.

Although the conventional arguments raised in favor of delivery may not be persuasive, the requirement of delivery need not be dispensed with. Because commodity futures contracts are intangible contract rights, contractors must believe those rights have value. If this belief depends on the fiction or myth that commodity futures contracts must be linked to the "real" world by being performable by delivery, one hesitates to abolish the delivery requirement.

The basic problem in the law dealing with the manipulation of commodity futures markets has been the confusion caused by the general rule against wagers. That commodity futures contracts must be performable by delivery has prevented administrators and courts from finding manipulation when traders simply insisted on delivery. For a trader to insist on delivery is generally the clearest evidence, and often the only evidence, of manipulation. The inability to rely upon this evidence has necessitated the task of proving manipulation through price distortion. Once the requirement of delivery is recognized for what it is—a lawyer's fiction that has be-

170. *See* T. Hieronymus, Economics of Futures Trading 86 (1971).

come an economist's myth—the way is clear. The solution to the *Volkart* dilemma is simply to recognize a trader's insistance on delivery for what it is—manipulation.

Traders who do not offset within a specified time before delivery should be presumed to be guilty of manipulation. This is not a novel proposal. A 1926 report by the Federal Trade Commission recognized that delivery was so unusual that it was often prima facie evidence of a manipulative intent for a trader to carry long positions late into a delivery month.[171] If a trader were presumed to intend to manipulate by holding a position for delivery rather than offsetting, the burden would shift from the CFTC's having to disprove innocence to traders' having to prove their innocence. This burden would not be nearly as onerous as the present one faced by the regulators. Traders have ready access to the evidence concerning why they have insisted on delivery. They can easily and quickly prove their innocence, and their proof would certainly be easier and quicker than the CFTC's burden of proving the elusive absence of justification. To require traders to do so conforms with a basic precept of evidence that, as between two parties, the party to whom the evidence is readily available should bear the burden of coming forward with it. As between the CFTC and the trader, only the trader can come forth with evidence that holding a position and demanding delivery was for a purpose other than manipulation.

Conclusion

The efforts by the CFTC to prevent the manipulation of commodity futures markets will continue to be thwarted by the delivery requirement, which is an historical hangover from the law of wagers. It is ironic that the intent-to-deliver rule—a rule originally embraced by the courts as a means of preventing manipulation—should now obstruct the efforts of government to prevent the manipulation of commodity futures markets. Once recognized, however, there is no reason why the "felt necessities"[172] of the past

171. *See* 7 F.T.C. Report 219 (1926).

172. *See* O. W. HOLMES, THE COMMON LAW 1 (1881). It is ironic that the person who wrote "[i]n the course of centuries the . . . necessity disappears, but the rule remains," *id.* at 5, would preserve the influence of the forgotten past by resorting to the legal fiction that offset is the equivalent of delivery. *See* Chicago Board of Trade v. Christie Grain and Stock Co., 198 U.S. 236 (1905).

should frustrate the prevention of the manipulation of commodity futures markets.

This Article has suggested as a solution to the *Volkart* dilemma that persons who insist upon delivery should be presumed to intend to manipulate. This is consistent with the substance of commodity futures contracts and does not entail a drastic change in the law or the customs and usages of commodity futures trading.